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SUBJECT: KAZAKHSTAN: GOK CONFIRMS "N BLOCK" PROCESS DELAYED

REF: ASTANA 562

Classified By: Pol-Econ Chief Deborah Mennuti; reasons 1.5(b) and (d).

1. (C) Summary: On March 15, ConocoPhillips (CP) executives briefed Energy Officer on CP CEO Jim Mulva's March 5 meetings in Astana, during which GOK officials reiterated the recent bad news about CP's "N Block" bid due to a GOK desire to re-evaluate "N Block" reserves, all commercial negotiations have been suspended for at least 4-6 months. Furthermore, Mulva was told, the GOK could not guarantee that CP and Shell would retain their current negotiating exclusivity when (and even "if") discussions resumed. While all of Mulva's interlocutors explained that a desire to reassess "N Block" reserves had driven the GOK's decision to suspend negotiations, Prime Minister Masimov also suggested to Mulva that the GOK would use the 4-6 months to assess "N Block" transportation options -- leading the CP executives to speculate that CPC expansion delays may have contributed to the "N Block" decision. The executives advanced other hypotheses as well -- that Kashagan delays and cost overruns have convinced the GOK that it must do more to extract maximum value from future Production Sharing Agreements (PSAs); that the GOK might be trying to slow the pace of offshore development in the face of a shortage of skilled Kazakhstani executives and laborers; and that the GOK is determined to better leverage the competition for offshore blocks to achieve economic diversification. The CP executives concluded, however, that the GOK reversal remains, fundamentally, a mystery, and asked for "high-level" USG help, both to discover the full reasons for the "N Block" policy shift -- and, if possible, to reverse it. End summary.

Delays of 4-6 Months "Or More"

2. (C) Arne Holhjem (Caspian Region President), Tim Wallace (Russia/Caspian Exploration Manager), and Nick Olds (Kazakhstan Country Manager) briefed Energy Officer on CEO Jim Mulva's March 5 meetings with Prime Minister Masimov, Energy Minister Izmukhambetov, and KazMunaiGaz (KMG) President Karabalin. Both Karabalin and Izmukhambetov had repeated the basic bad news: all "N Block" negotiations had been suspended, pending the completion of an "internal" (KMG) study of the "N" block reservoir (reftel). Karabalin told Mulva that the study would take 4-6 months to complete; Izmukhambetov had warned that the process could take "a year or two." "Don't get your hopes up," he warned Mulva. Masimov had sounded an even more ominous note, suggesting that, given transportation limitations, he could see no way to monetize "N" hydrocarbons quickly. "I can't see the near

term value of 'N Block'," he said, adding that, in addition to reassessing "N Block" reserves, the GOK would also be taking a close look at available oil and gas transportation alternatives. Masimov told Mulva that, in the face of all these issues, "we may keep "N" for future generations."

¶3. (C) Karabalin and Izmukhambetov warned Mulva that CP should not assume that, once resumed, the "N Block" negotiation process would take up where it had left off. Neither CP nor Shell were guaranteed preferential negotiating rights; the GOK might decide to open up the process to outside bidders. (Note: the CP executives told Energy Officer that they were not aware of any new competitors whose interest might have sparked the GOK's decision. While the German company Wintershall was rumored to be interested, the company had bid unsuccessfully on "N" years ago, and didn't appear to bring much to the table. National Oil Companies were a bigger potential threat, but CP had no evidence that any were pursuing "N." End Note.) Finally, Mulva was told, KMG might decide to develop "N" all by itself.

Speculating on GOK Motives

¶4. (C) Wallace told Energy Officer that, while the GOK appeared to have shifted its stance in "late December, it wasn't clear why. CP, he said, had no evidence the KMG had acquired new seismic data; their "internal study" would likely only reinterpret existing data. Wallace speculated that perhaps the intensity of Shell / CP competition for "N" had spooked the Kazakhstani government into thinking that the companies knew something about "N" reserves that it did not. In general, the CP executives said, Kazakhstan's oil-and-gas

ASTANA 00000684 002 OF 002

decision-makers appeared afraid to sign any deal that might later be seen as having conceded too much to an international oil company. The GOK had long seen the Tengiz deal in that light, Holhjem said, and the current Kashagan delays and cost-overruns had focused the GOK's attention on the fact that, given the cost-recovery provisions of the Kashagan Production Sharing Agreement (PSA), it would not receive substantial profits from the project for a decade or more.

¶5. (C) Wallace explained that Mulva had also come away from his Astana meetings, and subsequent consultations in Moscow, with the impression that the Kazakhstanis were increasingly troubled by CPC expansion delays and the effect failed negotiations would have on Kazakhstan's oil transportation plans. Masimov (para. 2) had raised the issue in terms of "N's" oil output, while both Izmukhambetov and Karabalin had placed new, strong emphasis on CP's need to develop "gas transportation options" as part of any future "N" bid. While Karabalin had noted that the Kazakhstanis supported the Trans-Caspian gas pipeline initiative, Wallace explained, the Kazakhstanis clearly were not focused solely on that project, and had asked CP to look at Gas-to-Liquids (GTL) and Liquefied Natural Gas (LNG) options as possible means to transport "N" Block gas. "They are clearly very motivated to get gas to market," Wallace concluded.

¶6. (C) Holhjem suggested that the GOK might be trying to slow down the overall development of its offshore sector, in the face of a shortage of not only skilled laborers and engineers, but also of skilled managers and executives within KMG and KazMunaiTeniz, its offshore operating subsidiary. The Kashagan project alone was currently short "a couple of thousand workers," he noted, and the Tengiz riots had made the GOK authorities more loathe than ever to try to meet the shortfall by bringing in foreign workers.

¶7. (C) Olds explained that, even in the best-case scenario, CP would likely have to submit an entirely new, improved proposal for "N" block development once KMG's reservoir study

was completed. Mulva's interlocutors had encouraged CP to take a "holistic" approach in its future bids, "in line with the President's recent address." Thus, CP's bid should address the issues of economic diversification (principally, but not exclusively, by means of a petrochemical proposal), technology transfer, and the creation of infrastructure which would benefit other, non-hydrocarbon, industries. As a consequence, Olds said, CP would likely re-evaluate its approach to the petrochemical issue. Olds reported that, to Mulva's surprise, Karabalin had also underscored Kazakhstan's interest in biofuel.

18. (C) Comment: While the CP executives -- clearly dejected by this turn of events -- give the impression that the GOK decision to suspend "N Block" negotiations is hard and fast, we will, of course, use every suitable opportunity to remind our GOK interlocutors of the high-level assurances we (and CP) received in December. End comment.
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